Lifestages KiwiSaver Scheme: Income & High Growth Fund Update

As at 31 March 2018

Funds Administration New Zealand Ltd ("FANZ") is the Manager of the Lifestages range of funds.

Welcome to your report for the period ending 31st March 2018. The last six months has been a period of two halves. As we noted in our last report investors found 2017 to be a "goldilocks" year (not too hot or cold!). Global stock markets finished the year producing double digit returns, and faster economic growth translated into earnings growth for listed companies, especially technology and energy companies.

Many US companies that derived significant earnings from their off-shore operations found that this too supported US company profit results. The "goldilocks" scenario played out because although growth forecasts were increasing, there was little sign yet of any rebound in inflation.

That scenario changed in early 2018. The US Fed stated that "inflation on a 12-month basis is expected to move up this year and to stabilize around the Committee's 2% objective over the medium term." A few days after this announcement was made the US non-farm payrolls report provided an indication that consumer prices are up this year in the United States. Employment increased by 200,000 in January, against expectations of an increase of 175,000. Average hourly earnings also increased by 2.9% to the year to January. Over the medium to long term higher consumer wages mean higher consumption which is positive for equity markets. However, it's not simple. This is because rising inflation could prompt the Fed to be more aggressive on raising interest rates (indicating more expensive credit that could slow consumer spending). This along with rising bond yields make risk asset less enticing, more so given the fully priced in nature of risk assets now.

What this does mean for investors? One key aspect to note is that the US (and NZ for that matter) won't be heading down the scenario that dogged Japan for over ten years when stagflation set in. Stagflation is an economic cycle in which there is low economic growth and employment and rising prices. This scenario is a nightmare to manage as it can be hard to break out of this type of economic cycle (as Japan has found over the last 20 years).

No stagflation is a good thing. What markets are currently grappling with is a modest return of inflation and the first signs of policy makers starting to raise interest rates to contain this trend. We can expect to see this type of scenario play out in markets over the course of 2018. It's also important to note that bond interest rate increases will result in higher bond yields over time. A bit of "pain" now will result in higher yields over time.

Closer to Home

This trend is also the situation in New Zealand. Whilst New Zealand is not in a position where interest rates will be increased in the short term, the GDP growth profile is one of strengthening GDP. An accommodative monetary policy, higher government spending and solid population growth will put pressure on GDP growth and hence inflation over the latter course of 2018. This solid growth underpins rising budget surpluses and falling debt as a percentage of GDP. This will also support company earnings growth and market performance over the coming year.

With respect to the shift to a centre left government in New Zealand at the last election, and its impact on the economic policy framework that will be rolled out over the next few years, we are reasonably relaxed about what will unfold. The simple reason for this is that (assuming the government of the day is looking to be elected for another term!) is that a New Zealand government of any shape or hue can't shift too far from the "centre". The writer's view is that the electorate simply won't tolerate a "big shift" and this position is reinforced by the disciplines enforced on parties under MMP, where you need to be able to negotiate and put together a coalition so as to be able to form a government. This means pursuing an economic frame work of orthodoxy with tilts to one side of the centre (or other), depending on who sits on the treasury benches at the time.

As we noted in our last report MMP, is all about the "art of the Deal." This comment appears to still hold true with respect to MMP. I'm reminded of one of my old bosses who would say, "If you haven't got any mates, when you need them it's too late!" Touche!

Performance

Members in both the Income Fund and High Growth Fund, plus the Lifestages Auto option, have experienced a positive increase in their return for the six months of 0–2%, with the High Growth Fund a lot more volatile than the Income Fund.

The excellent returns from Australian and Global equities in the December quarter were somewhat given back in the latest March quarter, with a rising New Zealand dollar in the March quarter further reducing the gains. The higher weighting to fixed interest in the Income Fund has helped offset the volatility of the equity markets. Rising interest rates globally have meant a flat return from international fixed interest. The good news from this is going forward, higher interest rates should deliver a higher ongoing regular income stream.

Longer term, the return for the High Growth Fund has been around 10% p.a. since inception. Both Funds and the four Auto options have performed in line with expectations during volatile market conditions.

For further details on the Funds and the four age ranges within the Lifestages Auto option, you should go to our website **www.lifestages.co.nz/kiwisaver/lifestages-kiwisaver-scheme-fund-and-investment-updates/** and look at the latest fund update. These documents will give you the latest returns, asset allocation and top 10 investments. The documents are updated quarterly.

Lifestages KiwiSaver Scheme Improvements

We wrote or emailed you recently about improvements to the Lifestages KiwiSaver Scheme. These included lower fees (which are in effect now), a new Auto option category and a plan to introduce a device friendly app for investor log ins to view your KiwiSaver account (which we are planning to introduce in July). We are also planning to develop other tools to help members such as a new planning calculator that will assist you in planning your financial future.

We look forward to being of service to you in the future. Please contact us if you have questions.

Funds Administration New Zealand Limited is the issuer of the Lifestages Kiwisaver Scheme.
The product disclosure statement for the Lifestages Kiwisaver Scheme is available at www.companiesoffice.co.nz/disclose (search for 'Lifestages Kiwisaver Scheme').